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# **Oman: Coping With the Weak Oil Market**

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**An Intelligence Assessment**

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# Oman: Coping With the Weak Oil Market

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An Intelligence Assessment

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**Oman: Coping With  
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**Key Judgments**

*Information available  
as of 12 October 1983  
was used in this report.*

Economic growth—fueled by oil revenues—will continue to be a key factor in the stability of the Omani Government as it has for the past 13 years of Sultan Qaboos's reign. Because oil provides 85 percent of total government revenues, Oman, like other oil exporters, has suffered from the weak market. We expect oil revenues to drop 14.3 percent during 1983, or by \$500 million, pushing Oman's budget into deficit. Oman, however, probably will run a small current account surplus and will be able to maintain imports near recent levels.

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We believe that Oman's economic problems are manageable in the near term, and prospects are good that the Qaboos regime will remain in power over the next three to five years. Sultan Qaboos remains firmly committed to a long-term relationship with the United States, which he views as Oman's principal deterrent to Iranian, Soviet, and South Yemeni security threats. Qaboos's willingness to cooperate closely probably will continue as long as he remains convinced that the United States takes seriously his security, economic, and political concerns.

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Oman's economic growth has been a source of strength for the regime, but the current slowdown is not likely to be politically threatening. Oman's modest economic contraction has not provoked significant grumbling in the population at large or among potentially troublesome groups such as university students, tribes, or expatriate workers. There are occasional reports that interior tribesmen are disgruntled over the uneven distribution of revenues between interior and coastal cities, but the regime is aware of these complaints and tries to alleviate grievances.

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We believe that even a continued weak oil market will do little damage to the economy because Oman enjoys relatively large financial reserves, an excellent debt-service ratio, and an ability to increase oil production to help offset lower prices. Oman's Government has not reduced spending, unlike some of the other Gulf states. Defense outlays remain among the highest per capita in the world. Some projects have been delayed, but Oman seems both intent on and capable of continuing most welfare and development plans designed to promote greater allegiance to the regime.

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Nonetheless, Oman is likely to turn to the United States and to its partners in the Gulf Cooperation Council (GCC) for help in softening the impact of the weak oil market. Oman, located on the Strait of Hormuz, will cite its strategic importance to the United States as an argument for increased US aid. The GCC has agreed to provide Oman with nearly \$2 billion in military assistance over the next 12 years and provided about \$200 million in economic aid during 1982. Disbursements for 1983 are likely to fall short of promises, given decreased revenues in the other Gulf oil-producing states.

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## Oman: Coping With the Weak Oil Market

Before the development of its oil resources, Oman's economy was based on agriculture and, to a lesser extent, on fishing. Oman did not begin exporting oil until 1967, and economic development began in earnest only after Sultan Qaboos assumed power in 1970.

Qaboos deposed his reclusive and repressive father in a bloodless coup with British help. His father was a tight-fisted dictator who refused to use Oman's oil revenues for public works or modernization. Qaboos inherited a stagnant economy not geared to exploit Oman's oil deposits. Oman had primitive communication, airport, harbor, and road systems and no modern schools or hospitals.

Statistics published by the Central Bank of Oman indicate that, despite growing revenues, the government ran budget and current account deficits from 1972 through 1978, except for 1977, because of Oman's limited financial resources, poor fiscal management, and the cost of suppressing a tribal rebellion in Dhofar Province.<sup>1</sup> Since then, the government has been in the black as a result of better control over public spending, reforms in fiscal and management procedures, and large world oil-price increases.

We believe the government's current revenue shortfalls and likely budget deficit are more significant than in the past because Qaboos has relied on Oman's oil wealth to finance far-reaching social and economic development programs to solidify his political control in Dhofar and in the rest of Oman. According to the US Embassy, he will look for ways to shield these programs and the populace from the effects of continued government revenue shortfalls.

### The Oil Sector

Under Qaboos, oil became the cornerstone of Oman's economy and the means for widespread economic

<sup>1</sup> The Dhofar rebellion began in 1963 as a secessionist movement by several Dhofari tribes who turned to South Yemeni tribesmen for help. This localized tribal revolt was transformed into a revolutionary movement—the Popular Front for the Liberation of Oman—supported by South Yemen and the USSR.



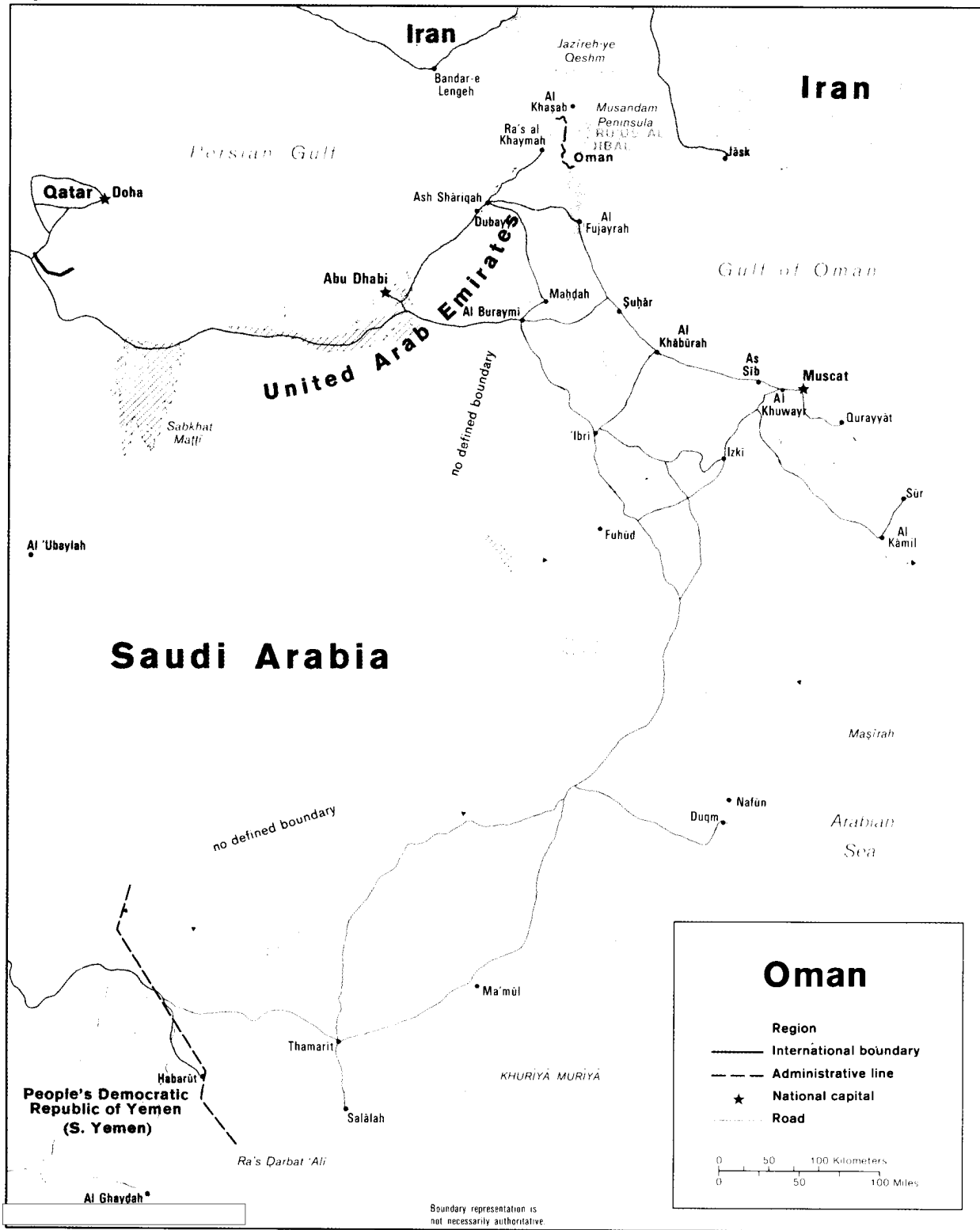
Sultan Qaboos bin Said

Pictorial Parade ©

development, particularly as revenues soared after the price rises of the early 1970s. Oman Central Bank statistics indicate that oil accounts for 92 percent of export earnings—\$4.08 billion in 1982—and 64 percent of gross domestic product. Our estimate of Oman's proved recoverable reserves is 2.7 billion barrels—enough to last about 20 years at 1983 average production rates of 360,000 to 380,000 barrels per day (see figure 2). According to Petroleum Development Oman—the government-owned oil company—prospects for further oil finds are good, especially in the Dhofar region.

According to US Embassy reporting, Oman is moving to expand its oil production, spurred in part by a need to shore up declining revenues for its 1981-85 development plan. In November 1982 Oman publicly announced a 10-percent increase in its 1983 average oil

Figure 1

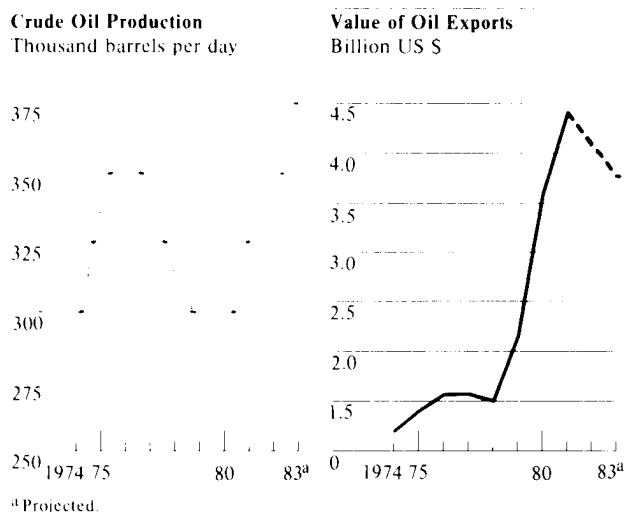


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**Figure 2**  
**Oman: Oil Production and Exports**



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output to 360,000 barrels per day—nearly equal to the peak in 1976 of 366,000 barrels per day. According to the US Embassy, current production, however, is already up to 400,000 barrels per day, which could push 1983 average production to over 380,000 barrels per day.

Petroleum Development Oman probably will be able to maintain production at these higher levels. Oman recently boosted its pipeline capacity from about 390,000-400,000 to 420,000 barrels per day by making repairs in the system.

Since oil production began in 1967, Oman has exported all of its crude and has relied on imported refined products for domestic consumption. Oman's new Mina Fahal refinery, however, is designed to provide the sultanate's needs for most products and, according to oil publications, is expected to operate at about 75 percent of its 50,000 barrel per day capacity during 1983.

Japan is Oman's principal customer, purchasing about half of Oman's crude. West Germany, the Netherlands, and Singapore are other major buyers. The US

purchases of about 10 million barrels of crude in 1982 made up about 8 percent of Omani exports, but were a negligible percent of US oil imports. According to the US Embassy, Oman has recently become dissatisfied with its contractual arrangements with the Japanese.

As a result, Oman is likely to solicit US companies to purchase larger quantities of its oil.

According to the US Embassy, Oman has recently begun to coordinate closely on oil policy with its partners in the Gulf Cooperation Council (GCC)<sup>2</sup>—perhaps to derive more benefits from GCC defense and development funds. Oman is not a member of either OPEC or its Arab counterpart, the Organization of Arab Petroleum Exporting Countries (OAPEC). According to press and embassy reporting, government officials believe that not belonging to either organization gives Oman greater flexibility to increase oil production to maximize its revenue levels. Oman usually abides by OPEC pricing decisions, and Omani marker crude prices probably will continue to accord with prices for Arab Light marker crude.

#### Spending Priorities

Oman was a late starter in the modernization race, compared to other Gulf states. According to Middle East economic publications, Deputy Prime Minister for Finance and Economy Qais Al-Zawawi and Sultan Qaboos would like to sustain spending and investment as long as possible to keep up the pace of development. Government spending has risen an average of 19 percent annually since 1980. Qaboos, who makes the final decisions on spending, gives defense the highest priority. During his tenure, however, he has also increased spending on social programs and economic development—especially in politically vulnerable areas to promote domestic stability. According to the US Embassy, the Sultan's economic policies have satisfied most Omanis. Even the most remote villages have benefited under his regime.

<sup>2</sup> The Gulf Cooperation Council is the economic and security grouping of the conservative Arab states of the Persian Gulf—Saudi Arabia, Kuwait, Bahrain, Qatar, Oman, and the UAE.

**Defense.** Because of the Dhofar rebellion, Oman's defense outlays over the past decade have been among the highest per capita in the world and, as a share of the budget, more than twice that of other Gulf states. We believe defense will continue to be a large budget item because of the Sultan's concern over security threats from South Yemen and Iran. Its share of total budget expenditures, however, probably will decline in favor of economic and social development in outlying areas. Statistics published by Oman's Directorate General of Finance indicate that 39 percent of Oman's 1983 budgeted expenditures are for defense, compared with 43 percent in 1982 and 44 percent in 1981. [REDACTED]

Budgeted defense expenditures for FY 1983<sup>1</sup> are \$1.77 billion, according to forecasts by Oman's Directorate General of Finance. [REDACTED]

**Development and Social Welfare.** According to the US Embassy, the government will try to maintain current and capital expenditures on development and social welfare near present levels. Social and economic reforms financed by Oman's oil receipts—which increased four times between 1974 and 1982—have improved the living standards of most Omanis and added to Qaboos's popularity. According to a recent academic study on Oman, the populace has come to depend on the government for subsidized basic commodities, foreign capital and consumer goods, interest-free business loans, land, and many jobs in both the public and private sectors. [REDACTED]

In our judgment, the current government development and welfare programs are intended to promote more equitable development between urban coastal areas and the impoverished interior. During the 1970s spending on economic and social programs was concentrated in Dhofar and the coastal cities in and

around Muscat, mainly to establish oil operations and port facilities. Although the Muscat and Dhofar areas will receive the highest percentages of regional investment—28 and 24 percent, respectively—under the 1981-85 five-year plan, the government is expanding its services and utilities to outlying areas. For the first time, the Musandam Peninsula is treated separately, taking 2 percent of regional investment (see figure 3). [REDACTED]

Development expenditures during 1981 and 1982 were about \$770 million and \$887 million, respectively, according to statistics published by the Central Bank of Oman. Over 70 percent went to Oman's civil ministries—mainly for projects in communications, industry, and the petroleum sector (see figure 4). [REDACTED]

According to the US Embassy, development expenditures in 1983 are set at over \$1 billion, and funding for most projects—schools, clinics, hospitals, and other social services—has been coming through on time. According to journals, most contracts for larger projects—Qaboos University, refineries, and highways linking Muscat with rural areas—have been placed, many with attractive credit terms. [REDACTED]

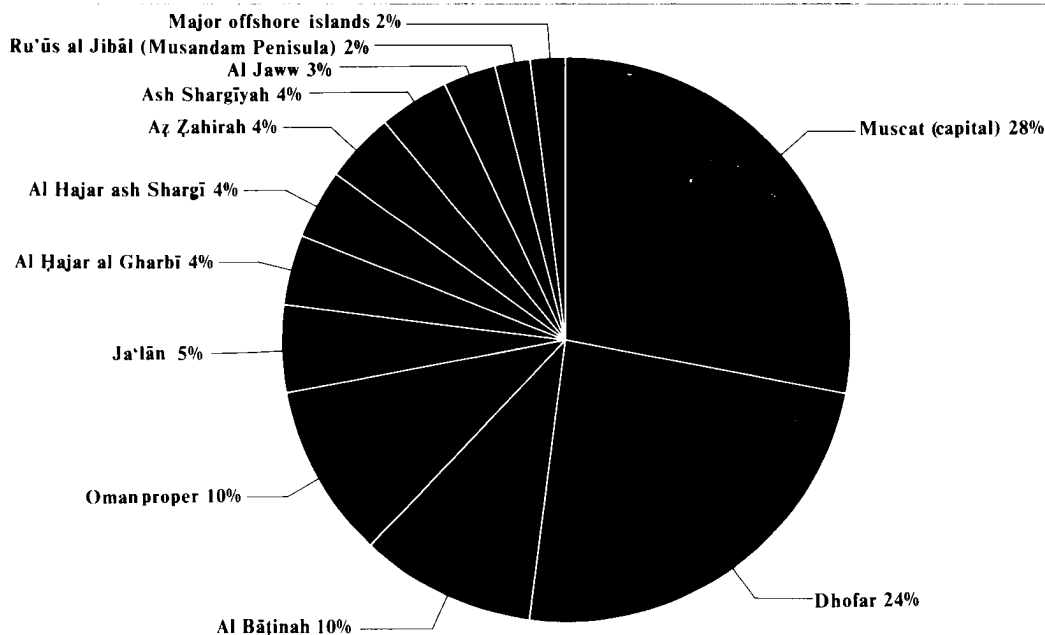
We believe that Oman now has increased long-term flexibility in development planning, despite current revenue problems, because most of its infrastructure projects have been completed. The port facilities are in place, the main roads are built, and sufficient power capacity is under construction to meet demand. Oman could scale back some development programs, such as refinery construction or nonoil industrial projects, if it faces major revenue shortfalls. [REDACTED]

#### **Economic Strategies**

Oman's oil revenues declined by 6 percent during 1982—from \$3.84 billion in 1981 to \$3.6 billion—and we estimate a further 15-percent decline in 1983. Oman's Directorate General of Finance, however, projects government spending to rise by over 13 percent in 1983—reflecting 20-percent increases in development and social welfare outlays and slight

<sup>1</sup> Oman's fiscal year corresponds to the calendar year. [REDACTED]

**Figure 3**  
**Regional Distribution of Investment**  
**Under Oman's Second Five-Year Plan**



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increases in defense spending to keep up with 6 percent inflation. The government's tendency since 1979 to underspend its budget by about 20 percent—primarily because of lack of expertise in implementing programs and unrealistic budgetary planning—probably will not balance the expected revenue shortfalls. [ ]

Oman's economic growth in 1983—barring a further drop in oil prices—is likely to slow to about 5 percent compared with over 30 percent in recent years. According to the press, senior Omani officials are aware that they cannot soon repeat the rapid growth of the late 1970s given global economic conditions. [ ]

If Oman's official oil price remains between \$28-30, we estimate that Oman would have a small surplus on its current account. The budget, however, would run a

deficit of about \$780 million on expenditures of almost \$4.5 billion—a significant downturn from last year's budget surplus of about \$96 million (see tables 1 and 2<sup>4</sup>). Oman's last budget deficit occurred in 1978. [ ]

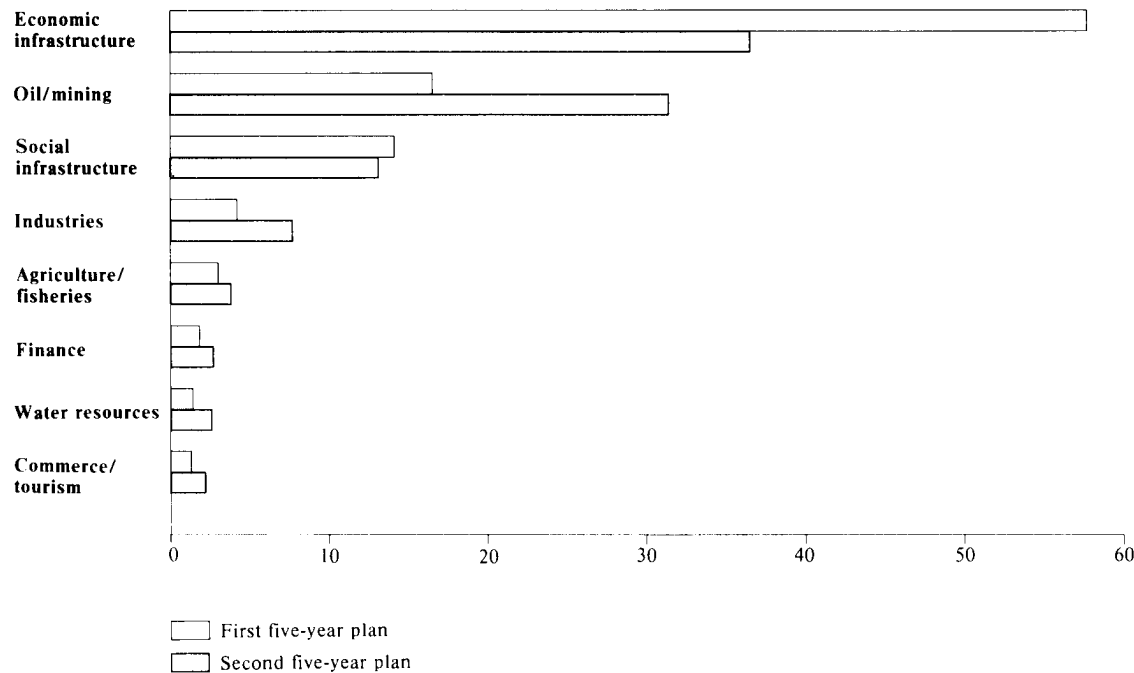
<sup>4</sup> The following assumptions are built into the tables' 1983 price scenario:

- No cuts in projected development.
- No cuts in US assistance; only partial fulfillment—\$75 million—of GCC military grants; does not include receipt of \$300 million Euromarket loan.
- No increase in remittance inflow/outflow.
- An inflation rate of 5 percent.
- No drop in oil export levels.
- Crude production of 380,000 barrels per day with domestic consumption of 37,000 barrels per day. [ ]

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**Figure 4**  
**Distribution of Government Development Expenditures**  
**by Economic Sectors**

Percent



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We believe Oman's Government probably will resist instituting austerity measures. Other Gulf states—particularly Kuwait and Qatar—have reacted to lower oil revenues by reducing government spending and raising utility prices. Some Omani development projects may be delayed, but more likely Oman will seek assistance from the United States and Arab sources to soften the impact of reduced revenues. [redacted]

It could also draw on its official foreign assets, which include net commercial bank assets (see table 3). We estimate Oman's official assets to be about \$3.5-4 billion in 1983, which would cover about one year of imports of goods and services at current levels. Oman has drawn on its reserves several times in the past, most recently in May 1982, when the government withdrew deposits from the sultanate's commercial banks. [redacted]

If oil revenues were to drop even slightly, Oman would run current account and budget deficits that would force it to draw down its assets or to make significant spending cuts. Oman also probably would request increased foreign aid under such circumstances, but we believe it probably would not receive much over the estimated \$200 million it is already getting from the United States and Arab donors. Although cuts in military expenditures would be unattractive to Qaboos, they would be a likely target because they consume more than one-third of the budget. Some weapons purchases probably would be

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**Table 1**  
**Oman: Government Finances, 1974-83**

Million US \$

	Actual									Estimated 1983
	1974	1975	1976	1977	1978	1979	1980	1981	1982	
<b>Revenues</b>	<b>902</b>	<b>1,300</b>	<b>1,463</b>	<b>1,774</b>	<b>1,473</b>	<b>2,184</b>	<b>3,277</b>	<b>4,384</b>	<b>4,184</b>	<b>3,886<sup>a</sup></b>
Oil receipts	844	1,080	1,316	1,396	1,326	1,839	2,407	3,260 <sup>a</sup>	3,063 <sup>b</sup>	2,623 <sup>b</sup>
General Reserve Fund <sup>c</sup>							502	583	540	463
Other (includes grants and domestic revenues)	58	250	147	378	147	345	368	541	581	800 <sup>d</sup>
<b>Expenditures</b>	<b>954</b>	<b>1,435</b>	<b>1,682</b>	<b>1,547</b>	<b>1,621</b>	<b>1,883</b>	<b>2,677</b>	<b>3,400</b>	<b>3,951</b>	<b>4,498</b>
Defense and national security	341	698	785	686	767	779	1,178	1,511	1,683	1,771
Civil purpose (mainly social welfare and development spending)	553	660	820	773	704	851	1,172	1,532	1,799	2,157
Oil sector operations	60	77	77	88	150	253	327	357	469	570
<b>Domestic net lending and equity participation</b>	<b>117</b>	<b>-3</b>	<b>1</b>	<b>23</b>	<b>53</b>	<b>18</b>	<b>73</b>	<b>111</b>	<b>137</b>	<b>176</b>
<b>Surplus/deficit</b>	<b>-169</b>	<b>-102</b>	<b>-220</b>	<b>204</b>	<b>-201</b>	<b>283</b>	<b>527</b>	<b>873</b>	<b>96</b>	<b>-788</b>

<sup>a</sup> We believe Oman's Central Bank estimates overstate oil receipts by over \$800 million.<sup>b</sup> Excludes transfer and allocations to the General Reserve Fund.<sup>c</sup> Fifteen percent of oil income is diverted into the State General Reserve Fund, established in 1980, which also receives any budget surplus from the previous year.<sup>d</sup> Includes estimated revenues of \$460 million from oil product sales for domestic consumption.

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**Table 2**  
**Oman: Current Account, 1974-83**

Million US \$

	Actual									Estimated 1983
	1974	1975	1976	1977	1978	1979	1980	1981	1982	
<b>Trade balance</b>	<b>600</b>	<b>407</b>	<b>484</b>	<b>481</b>	<b>329</b>	<b>852</b>	<b>1,683</b>	<b>1,975</b>	<b>1,276</b>	<b>1,130</b>
Exports and reexports, f.o.b.	1,213	1,416	1,595	1,619	1,598	2,280	3,748	4,696	4,423	4,025
Imports, c.i.f.	613	1,009	1,111	1,138	1,269	1,428	2,065	2,721	3,147	2,895
<b>Services and private transfers</b>	<b>-444</b>	<b>-558</b>	<b>-494</b>	<b>-447</b>	<b>-418</b>	<b>-522</b>	<b>-633</b>	<b>-793</b>	<b>-960</b>	<b>-1,140</b>
<b>Grant receipts</b>	<b>24</b>	<b>207</b>	<b>52</b>	<b>268</b>	<b>20</b>	<b>179</b>	<b>102</b>	<b>145</b>	<b>72</b>	<b>125</b>
<b>Current account</b>	<b>180</b>	<b>56</b>	<b>42</b>	<b>302</b>	<b>-69</b>	<b>509</b>	<b>1,152</b>	<b>1,327</b>	<b>388</b>	<b>115</b>

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**Table 3**  
**Oman: Official Net Foreign Assets, 1974-83**

Million US \$

	Actual									Estimated 1983
	1974	1975	1976	1977	1978	1979	1980	1981	1982	
<b>Net foreign assets</b>	<b>108</b>	<b>104</b>	<b>91</b>	<b>309</b>	<b>214</b>	<b>672</b>	<b>1,898</b>	<b>3,102</b>	<b>3,500</b>	<b>3,500-4,000</b>
Central Bank	100	161	199	280	175	411	730	1,042		
Government <sup>a</sup>	106	85	108	129	133	295	1,086	1,840		
Commercial Banks	-98	-142	-216	-100	-94	-34	82	220		

<sup>a</sup> Includes assets held by the General Reserve Fund.

delayed or even eliminated. Further substantial reductions in oil revenue probably would force the government to reduce subsidies and cancel some nonoil industrial projects. We believe that cuts in imports of consumer goods are less likely because they would be politically destabilizing among Omanis accustomed to fast-paced growth and the current standard of living.

**Financial Assistance.** We believe that Oman, in looking to the United States for additional financial assistance, would cite reduced revenues, its role as a reliable military partner, and its increased importance to security in the Strait of Hormuz and the whole Gulf region. According to the US Embassy in Muscat, the United States already has provided \$40 million in foreign military sales (FMS) credits for 1983, \$10 million in Economic Support Fund (ESF) loans, and \$5 million in ESF grants.

the Gulf Cooperation Council has agreed in principle to grant Oman nearly \$2 billion over the next 12 years to purchase military equipment. We believe, however, that Oman probably will not receive the entire amount because the Gulf states will be constrained by their own revenue problems. Other GCC transfers for arms purchases by Oman will remain at close to \$100 million in 1983 before dropping off as payments on contracts are fulfilled.

During mid-1982 the Omanis approached several Arab development funds with requests for concessionary loans to help finance 33 major infrastructure and social development programs totaling almost \$3 billion. According to the US Embassy in Muscat, the government hopes to obtain financing for up to 50 percent of the cost of these projects, most of which appear in the present five-year plan.

Oman has encountered problems in its recent requests for concessionary loans. The government's attempts to minimize its oil wealth by overstating budgeted expenditures and understating revenues are not fooling prospective donors. Oman's official revenue figure does not include the 15 percent of oil revenue (or budget surpluses) deposited into the General Reserve Fund, which is used to finance the general budget and to guarantee government loans.

We estimate that Oman can count on \$50 million at most in development aid from Arab donors in 1983 in addition to possible GCC military aid. According to the US Embassy, the Saudi Fund for Development has already approved two loans totaling \$16 million to finance two projects in Oman—a higher technical institute at Al Khuwayr and a vocational training center at Ibri. According to press and US Embassy reporting, at least two other projects for the Dhofar region may receive Saudi aid.

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Oman has a small foreign debt of about \$800 million and a respectable debt service ratio of about 3.5 percent<sup>3</sup> and could easily borrow on the international market. Oman already has arranged for a \$300 million medium-term Eurodollar loan to cover lower than planned foreign exchange earnings. Oman last went to the Euromarket in 1979 when a \$200 million medium-term loan was arranged. [ ]

#### Outlook

Oman's economic problems appear manageable, and we believe prospects are good that the Qaboos regime will remain in power over the next three to five years. We believe economic strains have not yet increased sufficiently to produce organized opposition. According to the US Embassy, there are sporadic rumors of dissatisfaction over uneven income distribution and limited economic opportunities. The Omani Government, however, recognizes the threat of tribal unhappiness and possible unrest and tries to alleviate grievances by making payments to tribal leaders and funding development projects in the interior. [ ]

If the oil market improves in 1984, as many oil analysts predict, Oman will be in a good position to proceed with its development plans—particularly in the areas of refining and enhanced oil recovery. According to the US Embassy, Oman intends to increase its crude oil production to 450,000 barrels per day by 1985, a boost of over \$700 million per year to government oil revenues if oil prices remain at \$29 per barrel. The added income would provide Oman with even greater resources to maintain defense and welfare spending levels and probably result in large budget and current account surpluses. [ ]

On the other hand, if the weak oil market continues into the middle of the decade, the government's ability to deal with likely revenue declines would be seriously tested. We believe Omani leaders would continue to seek loans and draw on foreign exchange reserves. Program delays and spending cuts would be necessary, most likely in the oil sector and luxury development projects. Reduced revenues would produce increased grumbling over high defense costs, the prevalence of imported workers, and official corruption. [ ]

<sup>3</sup> The average debt service ratio for developing countries, including short-term debt, is about 35 percent. [ ]

#### Implications for the United States

US-Omani cooperation rests primarily on a mutual desire to preserve regional stability and the security of the Qaboos government. The relationship is substantial and complex. [ ]

The Oman-US security relationship was upgraded and formalized in 1980 when both sides signed a US military access agreement. The agreement provides for extensive US operational access to Omani facilities and an agreement in principle for pre-positioning military stocks and staging operations. We believe Oman will continue to press for maximum remuneration for US access, particularly if its oil revenues continue to decline. [ ]

Oman also sees the United States as a source of economic aid, a relationship that will grow in importance if its oil revenues do not increase. According to US Embassy reporting, several Omani leaders hope to use US aid politically to demonstrate to their citizens and Arab critics that Oman has not signed a one-sided agreement. Omani officials, stressing the need for tangible evidence of benefits for Oman, were eager to establish the Joint Commission for Economic and Technical Cooperation in 1980. [ ]

Oman's economic well-being is important to its continued stability and its cooperation with the United States. If Oman's economic problems worsen, we believe it will attempt to press the United States for increased compensation and economic assistance as the price for military cooperation. US failure to respond to the Omanis' problems probably would accentuate their belief that the United States slights Oman compared with other major recipients of US aid in the region—Egypt and Israel. [ ]

We believe Qaboos is not opposed in principle to deepening and broadening the relationship. In our view, his willingness to cooperate closely will continue as long as he remains convinced that the United States takes seriously his security, economic, and

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political concerns and he believes the United States is firmly committed to the stability of his regime.

Qaboos appears to give more weight to the value of good relations with the United States and less weight to concerns of his Arab neighbors than do some of his advisers, according to US Embassy reporting. Over the longer term, economic problems might make Oman more susceptible to financial inducements from other Gulf states to resist expanded cooperation with the United States.

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